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WHEN SARS CHANGES ITS CASE: LIMITS OF TAX LITIGATION

*A judgment of the Megawatt Park, Johannesburg Tax Court in February 2025 (*IT25209*), now on appeal to the Supreme Court of Appeal (*Oakleaf Investments Holdings 79 (Pty) Ltd t/a Lesedi Power Company v Commissioner for the South African Revenue Service*), raises an important procedural question in South African tax litigation: to what extent may SARS reformulate its case during the appeal process without issuing a revised assessment?*

Although the underlying dispute concerns the deductibility of pre-trade expenditure, the significance of the matter lies elsewhere. The appeal turns on the proper interpretation and application of Rule 31 of the Tax Court Rules, and on the balance it seeks to strike between SARS' powers in litigation and the taxpayer's entitlement to procedural certainty.

The outcome of the appeal may have implications beyond the facts of the particular case.

THE STATUTORY FRAMEWORK: ASSESSMENTS, OBJECTIONS AND RULE 31

The Tax Administration Act, 2011, establishes a structured framework for the resolution of tax disputes. Once an assessment has been issued, a taxpayer may object to it and, if dissatisfied with the outcome, may appeal to the tax court.

Rule 31 regulates the stage at which SARS delivers its statement of grounds of assessment and opposing appeal. The purpose of the rule is to crystallise the issues that fall to be determined by the tax court. Rule 31(3) permits SARS to include a new ground of assessment, unless that ground –

- constitutes a novation of the whole of the factual or legal basis of the disputed assessment; or
- requires the issue of a revised assessment.

The rule therefore allows a degree of flexibility, while at the same time imposing limits designed to ensure procedural fairness and certainty.

The dispute in *Oakleaf (Lesedi)*

The taxpayer, an independent power producer, incurred substantial expenditure prior to the commencement of trade in developing a solar photovoltaic facility. In its 2014 year of assessment, it claimed deductions for this expenditure, described as "development fees", in terms of section 11A read with section 24J of the Income Tax Act, 1962 (the Act).

In its finalisation of audit letter and the additional assessment that followed, SARS disallowed the deduction on the basis that –

- the expenditure was capital in nature;
- the authorities relied upon by the taxpayer, including *Commissioner, South African Revenue Service v South African Custodial Services (Pty) Ltd* [2012] and *ITC 1870*, only applied to the now defunct section 11*(bA)* of the Act, which were applicable to preproduction interest and related finance charges, but were not applicable to section 24J; and
- the expenditure did not arise "in terms of" the relevant financial arrangements, notwithstanding any close connection to the raising of finance.

When SARS later delivered its Rule 31 statement, it maintained its opposition to the deduction but advanced a different basis for doing so. SARS accepted that "related finance charges" under section 24J may have a wide ambit and that costs not directly incorporated into loan agreements could, in principle, qualify. The focus of its opposition shifted instead to an alleged lack of factual particularity, contending that the taxpayer had not adequately demonstrated the necessary nexus between the expenditure and the relevant financial arrangements.